



# FOREIGN ASSETS CONTROL REGULATIONS FOR THE SECURITIES INDUSTRY

*Recently, a U.S. bank blocked a funds transfer en route to a U.S. securities account held in the name of an attorney residing in Geneva. Two broker/dealers and two clearing firms had been taking orders and operating securities accounts for him for quite some time and had understood that both he and his family enjoyed excellent reputations. What was the problem? The attorney had been identified as an agent of the Iraqi government and U.S. law required that his assets be blocked beginning in November of 1994. For the U.S. securities firms involved, each transaction handled for the attorney after his designation as a "Specially Designated National of Iraq" could mean civil penalties of up to \$275,000!*

*You might receive instructions from a long-time customer to wire sales proceeds to an account at the Arab Bank for Investment and Foreign Trade (ARBIFT) in the U.A.E. or to an account at Banque Intercontinentale Arabe (BIA) in Paris, France. All in a day's work, right? Wrong. These funds will most likely be blocked because both ARBIFT and BIA have been found to be acting on behalf of Libya. Your firm may be fined up to \$11,000 for initiating the transfer, even though your own bank blocked it. You'll also have to break the news to your client that his funds may be in limbo indefinitely.*

*You might also unwittingly open a margin account for a customer who happens to be a Cuban national, in which case the U.S. Government may be the least of your problems! Your firm could be on the hook for any purchases made on margin for this client before you realize that all of his U.S. assets are frozen.*

These examples illustrate how costly it can be to run afoul of U.S. laws enforced by the U.S. Treasury Department's Office of Foreign Assets Control (OFAC). OFAC administers sanctions and embargo programs involving Libya, Iran, Iraq, Sudan, and Cuba, and administers restrictions on imports from North Korea; prohibitions against certain imports, exports and services relating to the UNITA faction in Angola; prohibitions against imports from designated foreign persons who promote the proliferation of weapons of mass destruction; prohibitions against imports of rough diamonds from Sierra Leone, Liberia, and Angola; prohibitions against new investment in Burma (Myanmar); and prohibitions against transactions with designated terrorists and terrorist organizations, international narcotics traffickers, and parties related to a January 2001 Executive Order involving Serbia & Montenegro and a March 2003 Executive Order involving Zimbabwe. Securities firms are prohibited from dealing in securities issued from target countries and governments and must "block" or "freeze" accounts, assets, and obligations of an extensive number of blocked entities and individuals located in cities all over the globe. OFAC also administers sanctions involving the governments of Syria and North Korea, forbidding U.S. persons from receiving unlicensed donations from them and from receiving a transfer from them with respect to which the U.S. person knows or has reasonable cause to believe that the transfer poses a risk of furthering terrorist acts in the United States. OFAC also retains controls over certain assets blocked under previous programs against the Federal Republic of Yugoslavia (Serbia & Montenegro) and North Korea.

Criminal violations of the statutes administered by OFAC can result in corporate and personal fines of up to \$1 million and 12 years in jail. OFAC also has independent authority to impose civil penalties of up to \$275,000 per count.

To assure that illicit transactions are not processed, much of the banking industry has installed sophisticated and highly effective "interdict" software to block questionable funds transfers and other transactions. Because of the current level of electronic compliance programs in the financial community, it is more likely now than ever that violations by the securities industry will come to the attention of OFAC.

In light of this, targeted countries, entities, and individuals are likely in search of "safer places" to hide assets, including in securities firms. To prevent this from happening and to avert violations and costly enforcement actions, it is critical that securities firms establish internal compliance programs.

## OFAC Customer Assessment Checklist

It is recommended that you start by taking a look at your existing customer accounts to determine whether you are properly treating those that are blocked by existing sanctions, including:

- personal and commercial accounts held in the name of or on behalf of individuals or organizations appearing on OFAC's SDN list;
- accounts with Cuban addresses;
- personal accounts held in the name of nationals of Cuba, regardless of address (except nationals unblocked by OFAC license);
- accounts held in the name of the government of Cuba, Libya, Sudan, Iraq, pre-January 19, 2001 Serbia, or pre-January 19, 2001 Federal Republic of Yugoslavia (including all financial institutions and state-owned and socially-owned entities organized in the Federal Republic of Yugoslavia or located in the Republic of Serbia as of June 9, 1998, any successors to such entities, and their respective subsidiaries and branches, wherever located); and
- accounts owned by individuals acting for or on behalf of any of the account parties listed above or accounts owned by entities which are owned or controlled by any of the account parties listed above.

Continued trading on the national securities exchanges on behalf of blocked Cuban and North Korean customer accounts is authorized provided that certain conditions, which are intended to preserve the blocking of resulting assets and proceeds, are met.

Although no blocking provisions apply with regard to Iranian accounts, firms may not act on buy or sell orders originating from the Government of Iran, or individuals or entities located in Iran. At the request of the account holder, a firm may close out an Iranian account and effect a

one-time lump sum transfer of all remaining account funds and other assets to the account holder.

With regard to accounts for commercial enterprises operating in targeted countries, you should be aware that there is a prohibition on the performance of contracts in support of industrial, commercial, or governmental projects in those areas. This would include transferring funds to a third party in support of its operations in the targeted country.

## OFAC Securities Assessment Checklist

Next, you should review the securities in your custody to determine whether you are treating properly any that are blocked, including:

- securities registered or inscribed in the name of a Cuban national (regardless of whether the registered or inscribed owner appears to have assigned, transferred or otherwise disposed of the security);
- sovereign debt securities representing obligations of the governments of Cuba, Libya, Sudan, Iraq, Burmese development-related issues of the government of Burma or private firms subsequent to May 20, 1997;
- debt or equity securities representing obligations of, or ownership interests in, companies appearing on OFAC's SDN list;
- debt or equity securities representing obligations of, or ownership interests in, companies located in Cuba; or
- bankers acceptances that indicate on their face that they relate to unauthorized trade transactions involving North Korea, Cuba, Libya, Iran (post June 5, 1995 shipments), Sudan (post December 4, 1997 shipments), Iraq, exports of arms, arms materiel, petroleum, petroleum products, aircraft or aircraft components to UNITA or unapproved locations in Angola, exports of mining equipment, motorized vehicles, watercraft, spare parts for motorized vehicles or watercraft to unapproved locations in Angola, imports of uncertified diamonds from Angola, Sierra Leone, or Liberia, or imports produced or provided by foreign persons designated by the Secretary of State as having engaged in activities related to the proliferation of weapons of mass destruction.

You should also scrutinize any other securities which you have reason to believe represent obligations of, or ownership interests in, entities owned or controlled by blocked commercial or governmental entities referenced above.

## OFAC Banking Checklist

Before they are relayed to your bank, outgoing wire transfer instructions should be reviewed to insure that:

- neither intermediary banks nor banks of beneficiaries appear on OFAC's SDN list;
- the funds are not destined for Cuba, Libya, or Iraq;
- the beneficiary is not otherwise blocked (to determine whether a beneficiary is blocked, apply the same criteria as those found in the OFAC Customer Assessment Checklist); and
- The transaction is not related to commercial transactions in a targeted country.

## Blocked Accounts and Securities

Blockings must be reported within 10 days by fax to OFAC Compliance Division at 202/622-2426. Debits to blocked accounts are prohibited, although credits are authorized. Cash balances in customer accounts must earn interest at commercially reasonable rates. Blocked securities may not be paid, withdrawn, transferred (even by book transfer), endorsed, guaranteed, or otherwise dealt in without an OFAC license. OFAC also requires the filing of a comprehensive annual report on blocked property held as of June 30 by September 30 each year. The report is to be filed using Form TDF 90-22.50, which follows, and which is also available on OFAC's website or from OFAC's fax-on-demand service. Requests to submit the information in an alternative format or for an extension of the reporting deadline are invited and will be considered on a case-by-case basis by OFAC.

U.S. persons involved in litigation, arbitration, or other binding alternative dispute resolution proceedings regarding blocked property must: provide notice of such proceedings to OFAC Chief Counsel, submit copies of all documents associated with such proceedings within 10 days of their filing to OFAC Chief Counsel at U.S. Treasury Department, 1500 Pennsylvania Ave., NW — 3123 Annex, Washington, DC 20220, and fax information about the scheduling of any hearing or status conference to OFAC Chief Counsel at 202/622-1911.

### Hedge Funds and Alternative Investments

All investments and transactions in the United States or involving U.S. persons anywhere in the world fall under U.S. jurisdiction and need to comply with OFAC regulations. Because of their loosely regulated nature and the ability to handle transactions through offshore locations, US-managed hedge funds and other alternative investment vehicles may be attractive investments for sanctions targets. Hostile governments as well as persons, businesses and organizations linked to terrorism and narcotics trafficking have the potential to use such investments to gain access to the U.S. financial system or to launder money.

U.S. investment companies, managers and investors must be vigilant in dealing with these instruments, which include hedge funds, futures, derivatives and fund of funds. Hedge funds and their investment instruments are often once or twice removed from originating investments. U.S. managers and investors must be aware of all the underlying investments making up their portfolios. Funds may contain illegal investment vehicles such as sovereign bonds of the Republic of Cuba or those of other sanctioned foreign governments such as Iran, Iraq, Libya, and Sudan. Without proper authorization, it is unlawful for U.S. persons to invest in oil futures contracts involving Iraqi, Iranian, Libyan or Sudanese crude oil. All investment instruments should be scrutinized to assure that they do not represent obligations of, or ownership interests in, entities owned or controlled by sanctions targets.

U.S. companies and their offshore offices are responsible for maintaining identifying information concerning all clients, investors, and beneficiaries as well as for knowing the source of investment funds. It is recommended that identities be checked against OFAC's SDN list and reported if they appear to be authentic matches.

Please see OFAC's website for specific details concerning sanctions programs or call OFAC at 1-800-540-6322 to speak with an OFAC representative regarding individual questions and situations.

## Ongoing OFAC Compliance

The information on the OFAC assessment checklists will assist you when you evaluate new clients and unfamiliar investment securities. In addition, it may be helpful to designate a "Compliance Officer" responsible for monitoring compliance with OFAC programs and overseeing blocked accounts and securities. Internal auditing departments can assist in the development of "corporate compliance memoranda" and verification that procedures, once established, are being followed. An effective internal communication network is critical for regulatory compliance. Firms might consider including regulatory notices and explanations in staff newsletters. Compliance training programs will help prevent violations.

Other useful measures would include reviewing regulations in staff meetings, incorporating compliance requirements into operating procedures, and joining with other firms to sponsor compliance seminars.

The economic sanctions programs of the U.S. Government are powerful foreign policy tools. Their success requires the active participation and support of every U.S. citizen. Protect your firm from losses and civil penalty exposure — don't open your doors to OFAC targets; stay abreast of U.S. sanctions law. When in doubt about a specific account or transaction, or in need of additional information, contact OFAC's Compliance Hotline for financial institutions at **1-800-540-OFAC (6322)**. It should be noted that OFAC has a Miami branch office (909 Southeast First Avenue, Suite 735A) with a special bi-lingual hotline relating to information on the Cuban embargo; that hotline number is 305/810-5170.

## Additional Information

Whenever there is an update to any OFAC regulation, an addition or removal of an SDN, or any other announcement from OFAC, the information is quickly made available electronically via many different sources.

- All of OFAC's program "brochures," as well as SDN information, are available free in downloadable camera-ready Adobe Acrobat® "/\*.PDF" format over the Treasury Department's World Wide Web Server. OFAC's Home Page site is <<http://www.treas.gov/ofac>>. The Page also contains a self-extracting ASCII file of the SDN list in DOS, delimited, fixed-field, and country-specific versions, a free Adobe Acrobat Reader® to view and print "/\*.PDF" files, access to all OFAC-related Executive Orders, U.N. Resolutions, statutes, regulations, and the *Code of Federal Regulations* as well as to brochures in ASCII format, and a wealth of other material. All of OFAC's "forms," including its Annual Report on Blocked Property, Cuban Remittance Affidavit, and license application are electronically available on the site. The Treasury Department provides two E-mail subscription services—one to OFAC's Financial Operations Bulletin updates and the other to OFAC's "What's New" file. In addition, whenever there is a change involving urgent information requiring immediate implementation, the [DATE] changes on the face of the primary Page; users can automate their compliance by structuring their Internet connection to use a Web browser to watch for that date change, check a "Bulletin" file to get the details about changes, and download OFAC's latest information for incorporation, for example, into interdiction software. There is a separate date-indicator for OFAC's SDN list. OFAC's secondary Page on the site entitled "Recent OFAC Actions of Interest" contains date-specific "What's New" files with their own dates. Those not directly involved in operations areas can automate their ability to keep current with OFAC's general information by structuring their Internet connection to use their Web browser to watch for those date changes on the secondary Page to check the "What's New" file to get the
- details about changes, and download OFAC's latest information. There may be times when the date on the secondary Page will be later than the date on the primary Page because some OFAC "Actions of Interest" may not rise to the level of an urgent bulletin. Call OFAC Compliance at 1-800-540-6322 with any questions.
- OFAC operates a free automated **fax-on-demand service**, which can be accessed 24 hours a day, seven days a week, by dialing 202/622-0077 from any touchtone phone and following voice prompts. OFAC documents kept up to date on the system include program and general brochures, listings of Specially Designated Nationals and Blocked Persons, including changes to the listings, licensing guidelines, and *Federal Register* notices (even those filed but not yet printed in the *Federal Register*). The "Index of Available Documents" is date-specific.
- The free *Federal Bulletin Board* of the U.S. Government Printing Office, which is linked to the *Federal Register* and *Code of Federal Regulations*, carries all OFAC brochures in ASCII and Adobe/Acrobat "/\*.PDF" format, as well as the entire *Code of Federal Regulations* containing OFAC regulations, all *Federal Register* notices that OFAC puts out, and OFAC's extended electronic reading room (FAC\_MISC). For information on the *Federal Bulletin Board* call 202/512-1530 or dial 202/512-1387 to connect. The information is also available over the Internet via GPO ACCESS at <[fedbbs.access.gpo.gov](http://fedbbs.access.gpo.gov)>.
- Subscribers to Bloomberg via dedicated terminals should be able to find information on OFAC-administered sanctions by typing **OFAC <GO>**. Alternatively, subscribers may do a search utilizing the following keywords: government, government agencies, policy, terrorism-sponsoring organizations, trade sanctions, treasury, or united states.
- Information is disseminated by links from the web sites of the International Financial Services Association in New York (<<http://www.intlbanking.org>>) the International Banking Operations Association in Miami (<<http://www.iboa.com>>). Major announcements are also distributed to U.S. financial institutions through Fedwire bulletins and CHIPS system broadcasts, as well as, from time to time, in printed format through the various Federal bank supervisory agencies.
- The U.S. Maritime Administration's Web site at <<http://marad.dot.gov>> contains a special link to OFAC's brochures and information, including a flashing indicator of late-breaking updates. The U.S. Customs Service maintains a free *Customs Electronic Bulletin Board* geared especially toward Customs House Brokers (OFAC's information is available as a date-specific self-extracting DOS file, "OFAC\*.EXE" under "Files," and then "Customs Extra!," via the Internet at <<http://209.122.8.97>> or "cebb.customs.treas.gov". Numerous other industry groups link to OFAC's website, among them: the National Association of Securities Dealers (<<http://www.nasdr.com>>), the Securities and Exchange Commission (<<http://www.sec.gov>>), the Securities Industry Association (<<http://www.sia.com>>), the American Society of Travel Agents (<<http://www.astanet.com>>), the Institute of Real Estate Management (<<http://www.irem.org>>), and the Commercial Investment Real Estate Institute (<<http://www.cre.org>>).

## OFFICE OF FOREIGN ASSETS CONTROL

U.S. Department of the Treasury

1500 Pennsylvania Avenue, N.W., Washington D.C. 20220

202/622-2490

Fax: 202/622-2426

<http://www.treas.gov/ofac>